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October 28, 2005

***To the Citizens of the Commonwealth of Massachusetts,
Governor Mitt Romney, and Honorable Members of the
General Court***

I am pleased to present to you the Statutory Basis Financial Report (SBFR) of the Commonwealth for the fiscal year ended June 30, 2005 (FY05).

FY05 is the initial year of reporting for the Commonwealth's new web – based accounting system. This system was the most significant system upgrade for the Commonwealth in almost two decades. Through countless hours and teamwork involving all departments and our vendor, CGI-AMS of Fairfax, Virginia, we are proud to say that the system has most of its success factors. We have paid vendors since the day we turned the system on. Payroll was paid on a timely basis and revenue was collected. All of us who were used to our legacy system have had to learn to think differently and in some cases adjust business practices without compromising internal controls. I thank all of my staff and the many departments' staffs that work on the system on a daily basis for working with us to make this report happen. In FY06 (FY06) and beyond the challenge is to fully implement the functionality to fully achieve our return on investment.

The Commonwealth has continued to recover economically from the downturn of FY2002 (FY02) through FY2003 (FY03). Tax revenues from all sources continued to increase, rising by 8.9% after increasing by smaller percentages in FY03 and FY04. Unemployment continues to be slightly better than the nation, beginning the fiscal year at 5.3% and ending the year at 4.7%. Inflation in the Commonwealth however has risen to a non-seasonally adjusted 3.97% from July 2004 to July 2005. Fuel and utility prices (measured before the oil price shock related to Hurricane Katrina) rose nearly at nearly 15.7% over the same period. Fuel and utility prices will assuredly have a negative effect on the Commonwealth's economy as we continue into FY06. The Commonwealth continued to make difficult decisions to meet these challenges that lie ahead:

- In a reform of the nearly sixty year old school building assistance program, a The Massachusetts School Building Authority was created to finance school construction on a go-forward basis. In doing so, the Commonwealth has controlled the rate of spending and increased oversight and accountability of the program.

- In July 2004, the Governor signed into law an act that centralizes transportation planning and oversight. Transportation authorities such as the Turnpike and the Port Authority will remain legally separate. However, the Secretary of Transportation will serve as either chairperson or as a board member of those authorities beginning in FY08.
- To limit spending during the year, the Commonwealth continued to temporarily hold aside tax revenues that represent growth in excess of inflation. Beginning with this fiscal year, a portion of tax revenues also was directly deposited into the Stabilization Fund at fiscal year end to protect against the next economic downturn that is sure to come.
- Transfers from Stabilization Fund were used primarily to fund a final supplemental budget, funding Medicaid and other health – related spending, additional local aid, capital projects and other items.

Additional challenges lie ahead. Pension funding costs in FY05 were nearly double FY04, due to the actuarial phase-in of market losses in previous years, and the delay of the transfer of the Hynes Convention Center to the Commonwealth Retirement System to fund pension costs and early retirement. In future years, such costs are estimated to grow at approximately 4.8% per year.

The City of Springfield has come under fiscal oversight of the Commonwealth. The Commonwealth has appointed a fiscal control board and authorized up to \$52 million in loans to help the city. The board's ability to loan funds to the City expires on June 30, 2007. Repayments are due from the City without interest charges on or before June 30, 2012.

The Commonwealth finished the year ended June 30, 2005 with a budgetary gain (excess of revenues and sources over expenditures and uses) of approximately \$594 million increasing budgeted fund balances to \$2.5 billion. Of this balance, \$1.7 billion is sequestered in the Stabilization Fund. This balance represents 26 days of the total budgeted expenditures and other uses of FY05. An additional \$305 million is reserved in a Transitional Escrow Fund. This fund will supplement appropriations for FY06. In spite of the overall improvements in the economy, and in the financial condition of the Commonwealth, the challenges detailed above mean that our financial picture will remain cautious for the near future.

Financial Highlights

In the current fiscal year, the Commonwealth continued to take measures to maintain fiscal balance. Examples are as follows:

- \$343 million was transferred from the Stabilization Fund to pay for current expenditures. However, at the close of the

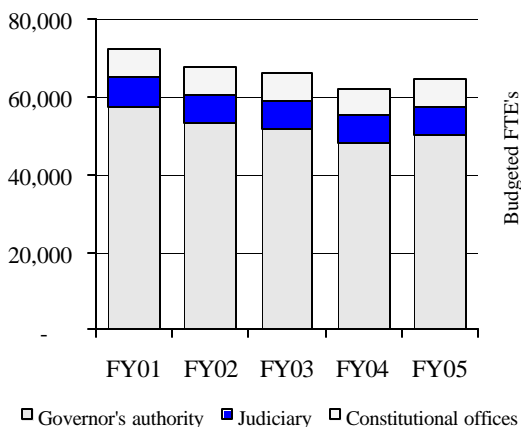
fiscal year, \$136 million was redeposited into the fund from tax revenues held aside during FY05. An additional \$691 million was transferred to the fund from operations, prior to the annual surplus calculation. Approximately \$4 million was deposited from tax revenues of certain lottery winners who sold their stream of future winnings in exchange for current payments. Also, nearly \$90,000 was recovered from Central Artery Project Costs. Finally, in FY05, an additional 0.5% of current year net tax revenues was deposited into the Stabilization Fund, amounting to \$85.9 million.

- Tobacco settlement proceeds for the year were \$257.4 million. The entire amount was used in support of current operations. The Commonwealth continues to refrain from issuing tobacco settlement bonds or pension obligation bonds, which many of our peer states have either considered or sold.
- To fund a cash flow deficit in the Unemployment Compensation Fund due to higher payments to recipients than receipts, the Commonwealth received interest-free loans from the federal government between March and April 2005, incurring a net total liability of \$208.5 million. All of these borrowings were paid back in May 2005. The balance of the fund has grown though to nearly \$415 million, or 24.7% of FY05 benefits paid.

The Commonwealth also took measures operationally to achieve balance and better fiscal management:

- The budgeted full time equivalent workforce including higher education, dropped from 66,024 as of June 2003 to 62,019 as of June 2004, but increased to 64,513 as of June 30, 2005. The graphic to the left details the changes over the last five years.
- Continuing in FY05, the employee's share of group health insurance premiums was 20% of the cost of the insurance for those who earn more than \$35,000. All new employees hired after June 30, 2003 contribute 25% of the cost of the insurance, regardless of salary. However, this figure reverts to the pre-2004 figure of 15% on January 1, 2006 for all employees.
- Tax decreases put in place earlier than FY02 remain frozen. The income tax rate remains at 5.3%. The graduated capital gains tax portion was challenged before the Supreme Judicial Court for Suffolk County in FY04. The FY05 General Appropriation Act attempted to fix the date of the latest change in capital gains rates to January 1, 2002 and offered a remediation for taxpayers who incurred capital gains from January 1, 2002 to April 30, 2002. However, the Supreme Judicial Court found these acts unconstitutional, effectively setting the capital gains transition date back to January 1, 2002 unless the Legislature takes further action. The Governor filed legislation reinstating the former graduated capital gains tax rates in effect in early 2002 as legal and enforceable and

**Budgeted Full Time Equivalent Workforce
Including Budgeted Higher Education
June 2001 – June 2005**



extending these rates for all of 2002. Should this action become law, refunds may be due to taxpayers.

Overview of the Financial Statements

This report includes the reports on the activity and balances of the budgeted funds, non-budgeted special revenue funds, capital project funds, fiduciary funds and the non-appropriated funds of higher education.

The financial operations of these funds are maintained in the Massachusetts Management Accounting and Reporting System, (MMARS). The statewide accounting system is operated by the Commonwealth and contains detailed information summarized in this report.

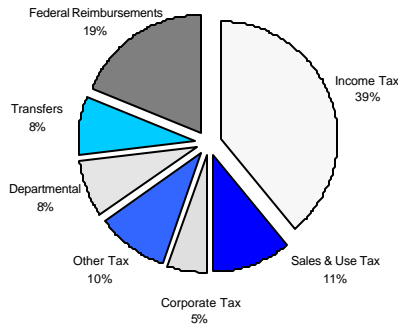
The SBFR is intended to satisfy the requirements of state finance law, and to present fairly the results of FY05 activity in the Commonwealth's funds. The report contains computations required by state finance law, including the certification of transfers to and balances in the Stabilization Fund and Tax Reduction Fund.

Basis of Accounting

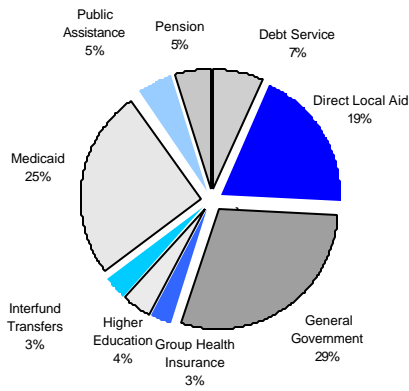
The statutory basis of accounting, defined in Massachusetts law, is used to budget and control fiscal operations. The statutory basis of accounting is not in conformity with accounting principles generally accepted in the United States of America, (GAAP) as defined for governments by the Government Accounting Standards Board (GASB). This report's purpose is to document compliance with Massachusetts state finance law. I will report the Commonwealth's financial position on a GAAP basis in December, in our Comprehensive Annual Financial Report, (CAFR). This report, which will be prepared in accordance with GAAP, provides a basis for comparison with other governments. There are significant differences between what is contained in the SBFR fund balance, revenues and expenditures and what will be presented in December under GAAP. The major differences include presentation of the historical cost of infrastructure (roads and bridges,) the recording of depreciation expense, the presentation of all types of debt on the face of the financial statements and the presentation of those financial statements in an all – encompassing, net assets and net expense format.

In accordance with Massachusetts General Laws, the Office of the Comptroller transmits the SBFR on or before October 31st. The SBFR report for fiscal year ended June 30, 2005 herein is audited by Deloitte & Touche, Independent Certified Public Accountants, and represents the conclusion of financial activity and the closing of the Commonwealth's books on the statutory basis of accounting for the fiscal year. This audit is conducted in conjunction with the Office of the State Auditor, which provides knowledge, expertise and resources to audit the financial statements.

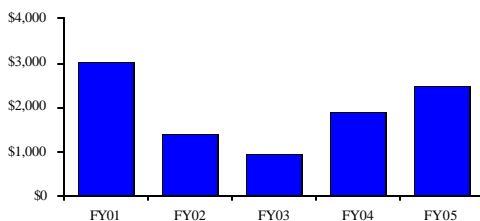
Budgeted Revenues and Other Sources



Budgeted Expenditures and Other Uses



Budgeted Funds – Fund Balance (Amounts in Millions)



The Budgeted Funds

In FY05, revenues and other sources continued to outpace expenditures and other uses of budgeted funds, resulting in an operating surplus of over \$594 million. This surplus is primarily a result of a rise in budgeted revenues and other sources of nearly \$385 million led by over \$718 million in increased budgeted tax revenues and over \$101 million in increased departmental revenues. Budgeted expenditures and other uses were up by more than 4.0% for FY05 largely isolated to increased pension funding, debt service increases and interfund transfers.

Any assessment surplus or deficit should be viewed in a trend. In that assessment, generally accepted standards indicate that a structural balance is achieved when revenues exceed expenditures over a period of multiple years. After operating deficits in FY02 and FY03, reliance on the significant use of prior year surpluses slowed in FY04 and continued to slow in FY05. As a result of FY05 operations, the Commonwealth was able to deposit \$691 million plus an additional 0.5% of tax revenues (nearly \$86 million) to the Stabilization Fund. In FY06 and in future years, the challenge will be to continue to match spending to available revenues.

In FY05, budgeted revenues and other sources increased 1.6% from FY04, primarily a result of tax revenue growth, departmental revenues and transfers from non-budgeted funds. Federal reimbursements declined approximately 7.9%. However, federal revenues in non-budgeted funds rose by 2.4%. From a multi-year perspective, the proportion of revenue sources demonstrate that tax revenues from all sources increased slightly with offsetting proportional drops in transfers and federal reimbursements.

Budgeted expenditures and other uses, including transfers to non-budgeted funds increased by 4.0%, primarily due to a \$515 million increase in pension funding mandated by the legislature and a \$161 million increase in debt service. Program services spending only increased by 2.2%, or \$448 million, primarily in Medicaid and other health and human services costs. The Budgeted Funds – Operations table on page 6 displays the FY05 summary of budgeted funds, compared to FY04. The FY05 financial statements for each of the 12 individual budgeted funds are included in the financial section of this report.

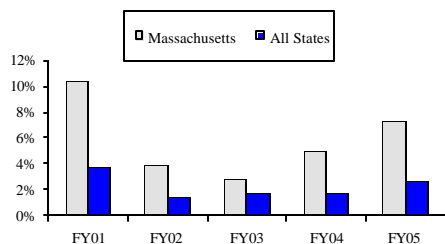
In conducting the budget process, the Commonwealth excludes those “interfund” transactions within the budgeted funds that are included in this report because by their nature, they have no impact on the combined fund balance of the budgeted funds. The table Budgeted Funds – Operations isolates this “interfund” activity from the budgeted sources and uses to align forecasts prepared during the budget process to actual amounts in this report. Transfers among the Budgeted Funds increased as a result of funds provided from Stabilization Fund to other funds to balance the budget for the year as well as year-end transfers back into the Stabilization Fund. A detailed list of these interfund transfers is included in Note 3 of this report.

Budgeted Funds - Operations
(Amounts in thousands)

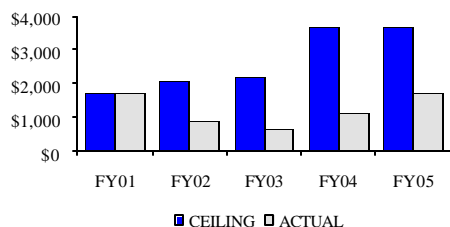
	2004	2005
Beginning fund balances:		
Reserved and designated.....	\$ 76,735	\$ 664,574
Reserved for Stabilization Fund.....	641,325	1,137,320
Undesignated.....	218,010	90,911
Total.....	936,070	1,892,805
Statutory fund reclassification.....	(183,285)	-
Adjusted beginning balance.....	\$ 752,785	\$ 1,892,805
Revenues and other sources:		
Taxes.....	15,268,976	15,987,399
Federal reimbursements.....	5,098,536	4,696,883
Departmental and other revenues.....	1,847,766	1,948,903
Interfund transfers from non-budgeted funds and other sources.....	1,773,068	1,740,248
Budgeted revenues and other sources.....	23,988,346	24,373,433
Intragovernmental Service Fund revenues.....	133,707	185,859
Interfund transfers among budgeted funds and other sources.....	1,924,930	2,045,364
Total revenues and other sources.....	26,046,983	26,604,656
Expenditures and other uses:		
Programs and services.....	20,036,542	20,486,991
Debt service.....	1,419,603	1,580,747
Pension.....	701,902	1,216,936
Interfund transfers to non-budgeted funds and other uses.....	690,279	494,377
Budgeted expenditures and other uses.....	22,848,326	23,779,051
Intragovernmental Service Fund expenditures.....	133,707	185,859
Interfund transfers among budgeted funds and other uses.....	1,924,930	2,045,364
Total expenditures and other uses.....	24,906,963	26,010,274
Excess of revenues and other sources over expenditures and other uses.....	1,140,020	594,382
Ending fund balances:		
Reserved and designated.....	664,574	355,615
Reserved for Transitional Escrow.....	-	304,838
Reserved for Stabilization Fund.....	1,137,320	1,728,355
Undesignated.....	90,911	98,379
Total.....	\$ 1,892,805	\$ 2,487,187

The graph of Budgeted Funds – Fund Balance, on page 5, portrays the combined fund balance in the budgeted funds for the past five years. This “bottom line” perspective demonstrates the accumulation of resources attributable to balanced budgets through FY01 and the reliance on these resources through FY03 as spending was adjusted to align with the lower revenue base. As part of the General Appropriation Act of FY04, the Convention and Exhibition Center

Stabilization Fund Balance as a Percentage of Budgeted Expenditures



Stabilization Fund – Fund Balance (Amounts in Millions)



Stabilization Fund Activity in FY 2005 (Amounts in Thousands)

Balance as of June 30, 2004	\$ 1,137,320
Add: Investment income	17,270
Taxes.....	3,996
Recoveries of Central Artery Project Costs.....	90
FY05 Statutory Transfer.....	691,000
0.5% of tax revenue per statute.....	85,959
Transfers from Temporary Holding Fund	<u>135,991</u>
Subtotal	2,071,626
Less: Transfers and Appropriations from Stabilization	(343,271)
Balance as of June 30, 2005	<u>\$ 1,728,355</u>

Fund, a large contributor to budgeted fund balance was redefined as non-budgeted, resulting in a beginning balance restatement for FY04. Fifty other budgeted funds were either reclassified to non-budgeted, trust funds or closed as part of the General Appropriation Act, all of which are reflected as a restatement of beginning fund balance, leaving a clearer definition of budgetary activity. In FY05, the ending balance is comprised of the statutory fund balance of the General Fund, the Stabilization Fund, the Workforce Training Fund, the Massachusetts Tourism Fund and the Transitional Escrow Fund, offset by deficits in the Highway and Children's and Senior's Health Care Assistance Funds. A solution needs to be found to address the chronic deficit in the Children's and Senior's Fund. Due to designations within these fund balances, \$660 million of the total budgeted fund balance, exclusive of stabilization, is either reserved or is available for appropriation in FY06. The remainder is undesignated.

The Stabilization Fund

With the rapid depletion of the accumulated balances over the last three years, the importance of the balance in the Stabilization Fund and its direct correlation to the financial condition of the Commonwealth is clear. The National Governor's Association, along with the National Association of State Budget Officers in their annual "The Fiscal Survey of States" ranked the Commonwealth in FY04, third in the nation in terms of the balance of stabilization. Nine states had no stabilization balance at the end of FY04. Even more impressive, of states with over \$10 billion in General Fund expenditures in FY04, the Commonwealth's stabilization balance, as a percentage of expenditures, was first in the nation with Florida and California following. As the graphic at the left portrays, the Commonwealth has continued to outpace the rest of the nation in this key element of fiscal condition.

State finance law, as amended during FY03, increased the maximum balance that may accumulate in the Stabilization Fund to a level equal to 10% of budgeted revenues and other sources. This ceiling increased to 15% in FY04. The law then directs that any amount in excess of this "cap" be transferred to the Tax Reduction Fund for future, one-time, personal income tax rebates. Due to the significant transfers out of Stabilization over the last three years, it will be a while before the "cap" will be reached. The details of these calculations can be found on pages 278 through 283 of this report.

The graph, Stabilization Fund - Fund Balance portrays this "cap" and the balance of the fund over a five-year period. A balanced budget or "Consolidated Net Surplus," was redefined for FY04 to include all undesignated fund balances in the budgeted funds except for the Inland Fisheries and Game Fund. Starting this year, an additional 0.5% of current year tax revenues was deposited into the Stabilization Fund before the year-end surplus is determined.

The trend to fragment the budget into such special interest funds was addressed with consolidation and closure of the majority of budgeted funds activity in FY03. In the future, we must be very careful in only adding budgeted funds when absolutely necessary.

The Non-Budgeted Funds

The Non-Budgeted Funds represent operations in which the government has imposed its sovereign authority, but has excluded these operations from the annual budget process. During FY05, the Commonwealth maintained 51 of these funds, including certain funds that had previously been reported as budgeted. The largest non-budgeted funds in terms of revenues include the Lottery, Federal Grants, Health Care Security Trust (designated to receive tobacco settlement funds before transfer to the General Fund), Grant Anticipation, MBTA State and Local Contribution Fund, the Medical Security Trust, the Health Care Quality Improvement Fund, the new School Modernization and Reconstruction Trust (SMART) Fund and the Uncompensated Care Funds. These funds are commonly referred to as special or dedicated revenue funds whose revenues are matched to related expenditures.

The table, Non-Budgeted Funds – Operations, includes a summary of the FY05 non-budgeted funds. Financial statements for each of the individual funds are included in the financial section of this report. Several of these funds are worth mentioning.

At June 30, 2005, the Federal Grants Fund had a positive fund balance, but there is a deficiency in cash within the fund. This cash deficiency results from the Commonwealth drawing funds from the federal government a few days after applicable cash disbursements had been made to ensure an “interest neutral” timing of the federal – state cash exchange. These requirements were established by the Cash Management Improvement Act of 1990. Within the Lottery Funds, gross revenues continued to increase this fiscal year. The Lottery continues to be a strong source of cash flow for the Commonwealth.

Non-Budgeted Funds - Operations (Amounts in thousands)

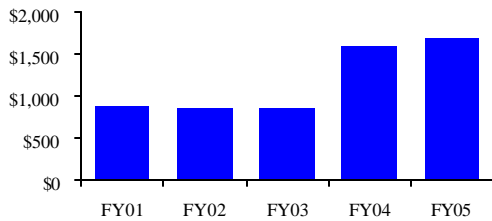
	2004	2005
Beginning fund balance.....	\$ 862,572	\$ 1,592,311
Legislative fund reclassification.....	183,285	-
Adjusted beginning balance.....	1,045,857	1,592,311
Revenues and other sources:		
Taxes.....	785,642	1,204,447
Assessments.....	619,013	662,491
Federal grants and reimbursements.....	3,252,986	3,305,415
Tobacco Settlement revenue.....	253,621	257,417
Departmental and miscellaneous.....	5,406,115	5,758,109
Transfers and other sources.....	1,647,220	1,052,134
Total revenues and other sources.....	11,964,597	12,240,013
Expenditures and other uses:		
Programs and services.....	8,602,787	9,553,409
Debt service.....	96,219	118,018
Transfers and other uses.....	2,719,137	2,474,769
Total expenditures and other uses.....	11,418,143	12,146,196
Excess of revenues and other sources over expenditures and other uses.....	546,454	93,817
Ending fund balance.....	\$ 1,592,311	\$ 1,686,128

The Health Care Security Trust Fund (HST) reports all revenues received from the Master Settlement Agreement (MSA) between the states and the tobacco industry to recover healthcare costs for tobacco related illnesses. The MSA estimates the Commonwealth revenues for the first 25 years of the settlement to be approximately \$7.6 billion. However, this estimate is prior to possible future adjustments, including adjustments for inflation and changes in the volume of domestic cigarette sales. In FY05, the Commonwealth received over \$257 million or 91.0% of the estimated amounts shown in the MSA. All HST proceeds received in FY05 were transferred to the General Fund. The Fund was also used as a cash flow mechanism for the new Health Care Quality Improvement Fund. The HST also returned \$43.9 million in FY04 investment earnings to the General Fund during FY05 pursuant to Massachusetts General Laws.

During FY98, the Legislature authorized the issuance of up to \$1.5 billion in Federal Grant Anticipation Notes, (GANS) to finance the current cash needs of the Project. All of the GANS have been issued. The GANS are not considered general obligation debt of the Commonwealth. These proceeds of the GANS are being used to pay for federally eligible expenditures. GANS activity related to the Central Artery / Tunnel Project (CA/T) continued this year, though only for debt service and for previous expenses that became reimbursable by the federal government. From this year through 2015, these eligible expenses will be reimbursed by the federal government and the reimbursement will be used to payoff the GANS. Activity related to issuance of GANS and the accumulation of pledged funds and the payment of debt service is accounted for in the Grant Anticipation Note Trust Fund. In July 2003, the Commonwealth completed a cross-over refunding of the GANS. \$388.1 million in GANS issued in 1998 and 2000 at coupons ranging from 5.125% to 5.75% that will mature on December 15, 2008 and 2010, respectively, were partially refinanced with \$408.0 million of refunding notes with yields of 2.51% to 3.39%. The interest on the newly issued refunding notes is paid from an escrow until final redemption. This technique results in economic savings, but does not result in the legal defeasance of the notes. The result is the original as well as the refunding notes are reported on Commonwealth's books until the maturity dates. The \$649 million surplus in the fund for FY05 represents \$542 million held for payment of interest on the GANS inclusive of an escrow for payment of GANS involved with the aforementioned crossover refunding. The fund also started to accumulate grant draws to pay principal amounts coming due in FY06 during FY05.

The Universal Health Care funds, including the Uncompensated Care and Medical Security Trust Funds, have reported revenue and other financing source increases of over \$633 million. However, \$345 million was transferred out to fund operations this year due to the continued high cost of health care. As of the end of FY05, these funds have a combined fund balance of over \$202 million.

***Non-Budgeted Funds –
Fund Balance
(Amounts in Millions)***



The graph Non-Budgeted Funds - Fund Balance shows the combined fund balance in the Non-Budgeted funds for the past five years. In each year, the entire balance is designated for the specific purpose of the fund. The overall growth in fund balance in these funds this fiscal year was primarily due to deposits into the Community Preservation Trust Fund. As indicated in previous years, more consolidation and elimination is needed for these funds. For example, the Government Land Bank Fund has a chronic structural fund deficit. The FY05 deficit balance of \$35 million remains an unbudgeted drain in cash flows in the General Fund. While steps have been taken to stop the growth in this deficit, the Fund should be abolished and the deficit transferred into the General Fund. An additional \$21 million deficit exists in the Motor Vehicle Inspection Fund. Amendments to the enabling statute to the Fund mandate that the Fund must be in balance by June 30, 2009.

The Capital Projects Funds

The purpose of these funds is to account for the construction or acquisition of capital assets. The Governor may propose capital outlay budgets, which, upon enactment by the Legislature and approval by the Governor, become capital outlay acts. Capital outlay acts financed through the sale of debt require a two-thirds vote of the Legislature. Numerous acts may be combined for reporting in an individual Capital Project Fund, but each act is accounted for separately within the Capital Projects Fund. These accounts record authorizations for expenditures in itemized capital appropriation accounts and equivalent authorizations to issue bonds or notes in anticipation of federal reimbursements.

The structure of these funds is such that each capital outlay authorization is in balance, creating authorization for inflows, which may be from sales of bonds, federal reimbursements or other revenues and authorization for expenditures. Imbalances due to timing differences develop when the expenditure precedes the inflow of funds from the sale of bonds or federal reimbursements. Because of federal tax arbitrage rules, it is more difficult to sell bonds in anticipation of expenditures. The sale of bonds in advance is not commonplace in the Commonwealth.

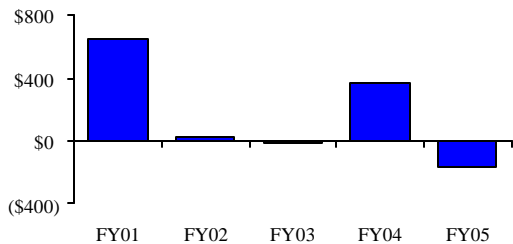
The Commonwealth issued over \$2.7 billion in debt this year. Of this amount, \$1.4 billion, inclusive of premiums, was used to fund ongoing projects, including \$500 million to fund school construction as part of the restructuring of the school building assistance program and nearly \$1.3 billion was issued in the form of general and special obligation refunding bonds, taking advantage of low interest rates.

A significant portion of the Capital Projects activity continues to relate to the Central Artery / Tunnel Project (CA/T). The CA/T has been the target of an enormous amount of public scrutiny. The Commonwealth has aggressively responded to these concerns regarding the integrity of the cost estimates. For the third year, an independent evaluation of the entire estimate for the project has been undertaken. The current cost of the project still stands at \$14.625 billion. The federal government has capped its contribution to this project at \$8.5 billion or 59% of the budget. The finance plan also includes Commonwealth sources to fund

Central Artery / Tunnel Project
(Amounts in Billions)

Sources of Funds:	2004	2005
Federal Funds	\$ 7.049	\$ 7.049
GANS	1.500	1.500
Massachusetts Turnpike Authority	1.658	1.658
Massachusetts Port Authority	0.302	0.302
Other Commonwealth Debt	3.931	3.931
Commonwealth Operating Funds and Investment Earnings	0.185	0.185
Total Sources	\$ 14.625	\$ 14.625
Costs of Construction:		
Cumulative Costs at Beginning of Fiscal Year	\$ 12.728	\$ 13.317
Current Fiscal Year Spending	0.589	0.811
Actual Costs through End of Fiscal Year	13.317	14.128
Estimated Spending:		
FY05	0.801	-
FY06	0.507	0.497
Total Estimated Costs of Construction:	\$ 14.625	\$ 14.625

**Capital Projects Funds –
Fund Balance (Deficit)**
(Amounts in Millions)



a large portion of the project. The project is over 97% complete as of the latest Project Management Monthly report released in September 2005.

The major elements of the project are open to traffic. In addition, completion of various ramps, surface reconstruction projects and other features is required for substantial completion of the CA/T Project as a whole. The date of substantial completion of the CA/T Project is projected for the late fall of 2005, except for construction of one ramp and of the downtown surface street system, which is scheduled for completion before the end of 2005. Final surfacing of the surface roadways is likely to occur in the Spring of 2006.

Pursuant to statute and agreements with the Massachusetts Turnpike Authority (MTA) and the Massachusetts Port Authority (MassPort), the entities have committed to significant ongoing contributions to the Commonwealth as part of the financing for this project. These funds are in addition to funds from the Commonwealth and federal funds for the project. In August 2005, MassPort remitted to the Commonwealth \$50 million as part of this commitment. The funds were used to retire bond anticipation notes.

The graph Capital Projects Funds – Fund Balance (Deficit) shows the combined fund balance in Capital Projects Funds for the past five years. The graph shows a deficit in the funds in FY05 due to the timing of bond sales. A bond sale in August 2005 erased this deficit. The majority of the individual funds remain in deficit due to the timing differences between bonding and expenditures offset by surpluses in three funds. These three funds include a fund for central artery and statewide roads and bridge construction, a fund for the Commonwealth's Convention Centers and a fund for the federal highway construction program. These funds contain designated reserves or escrows where the Commonwealth is able to legally arbitrage revenues consistent with the provisions of the existing tax code.

The Capital Projects Funds – Operations table on the next page, includes the FY05 Capital Projects Funds, summarized and compared to FY04. Financial statements for each of the individual funds are included in the financial section of this report.

The Administration has implemented a coordinated fiscal strategy for the management of Capital Projects Funds. This strategy includes a five-year capital budget linked to debt management and cash management. The focus of this strategy is to manage capital spending and outstanding debt to levels the Administration considers appropriate for the Commonwealth. An important part of the strategy is to control capital spending within an annual administrative "cap."

Capital Projects Funds - Operations
(Amounts in thousands)

	2004	2005
Beginning fund balance (deficit).....	\$ (9,994)	\$ 364,849
Revenues and other sources:		
Federal grants and reimbursements.....	3,408	11,626
Departmental and miscellaneous.....	22,985	23,513
General and special obligation financing.....	1,993,080	1,354,228
Proceeds of refunding bonds.....	2,832,866	1,384,763
Transfer for Federal Reimbursements.....	598,955	331,436
Transfers and other sources.....	154,428	239,552
Total revenues and other sources.....	5,605,722	3,345,118
Expenditures and other uses:		
Acquisition of assets.....	2,229,611	2,534,947
Payments to refunded bond escrow.....	2,832,866	1,153,150
Transfers and other uses.....	168,402	182,770
Total expenditures and other uses.....	5,230,879	3,870,867
Excess (deficiency) of revenues and other sources over expenditures and uses.....	374,843	(525,749)
Ending fund balance (deficit).....	\$ 364,849	\$ (160,900)

The Fiduciary Funds (Excluding Agency Funds)

The Fiduciary Funds record the Commonwealth's responsibility for assets it controls on behalf of other parties. Examples of such funds are the Unemployment Compensation and Pension Trust Funds. The table on the following page, which excludes assets held on a purely custodial capacity in so-called Agency Funds, summarizes the FY05 activity of the Fiduciary Funds. Nearly 98% of the Fiduciary Fund assets are related to the Commonwealth's Pension Fund detailed in fund statements found in this report.

The \$3.8 billion operating gain in this fund group is primarily the result of the net of two significant events:

- The net change in value of pension assets increased by over \$4.0 billion.
- Payments to the unemployed in the Commonwealth were exceeded employer contributions to the Unemployment Compensation Trust Fund by nearly \$293 million. Expenditures from the Fund reduced during the year, reflecting an improving economy.

The pension valuation is based on data as of January 1, 2005. Details of this valuation are outlined in Note 10. The value of pension assets of the public retirement system decreased from FY04 to FY05 from 73.9% funded to 72.3% funded. This was due to the continued phase in of realized and unrealized losses from 2002 to 2004. However, within the systems, the Teachers' Retirement System and the State – Boston Retirement System are funded at 67.6% and 48.8% respectively. A long term solution is needed to address these funding concerns.

Fiduciary Fund - Operations (Excluding Non-Expendable Trusts)
(Amounts in thousands)

	2004	2005
Beginning fund balance.....	\$ 27,673,480	\$ 31,721,983
Revenues and other sources:		
Taxes.....	1,264,364	1,670,942
Federal reimbursements.....	831,727	262,973
Departmental and other revenues.....	1,943,489	2,419,738
Interfund transfers and other sources.....	178,553	179,008
Unrealized and realized investment earnings / (losses).....	5,104,754	4,021,248
Total revenues and sources.....	9,322,887	8,553,909
Expenditures and other uses:		
Expenditures.....	5,031,389	4,460,781
Interfund transfers.....	242,995	266,988
Total expenditures and uses.....	5,274,384	4,727,769
Deficiency of revenues and sources over expenditures and uses.....	4,048,503	3,826,140
Ending fund balance.....	\$ 31,721,983	\$ 35,548,123

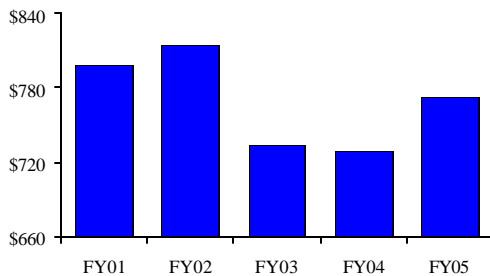
The Non-Appropriated Funds of Higher Education

The SBFR includes the financial operations of the non-appropriated funds of the 25 institutions of higher education in the statistical section of this report. Each institution of higher education is authorized and directed in its enabling statute to collect, retain and expend certain fees, rents, sales, donations, federal financial participation and other types of revenue through campus based systems. These financial resources are integral parts of the total financial activity of each campus. They also represent resources in addition to amounts made available from Commonwealth appropriations. Over the past few years, significant efforts have been taken by our office and the institutions to improve the accuracy and timeliness of the higher education segment of the financial report.

Non-Appropriated Funds Of Higher Education - Operations
(Amounts in thousands)

	2004	2005
Beginning fund balance.....	\$ 733,274	\$ 729,079
Revenues and other sources:		
Federal Grants and reimbursements.....	339,160	348,340
Departmental and miscellaneous.....	1,550,644	1,056,087
Transfers and other sources	150,694	999,404
Total revenues and other sources.....	2,040,498	2,403,831
Expenditures and other uses:		
Programs and services.....	2,044,693	2,359,664
Total expenditures and uses.....	2,044,693	2,359,664
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	(4,195)	44,167
Ending fund balance.....	\$ 729,079	\$ 773,246

***Non-Appropriated Funds of Higher
Education – Fund Balance***
(Amounts in Millions)



The Non-Appropriated Funds of Higher Education – Operations table includes the FY05 funds, summarized and compared to FY04. Financial statements for each of the individual funds are included in the statistical section of this report. The graph Non-Appropriated Funds of Higher Education – Fund Balance shows the combined fund balance for the past five years. The combined balance represents \$518 million for the University of Massachusetts, \$149 million for the State College system and \$107 million for the Community Colleges. These balances are designated for specific purposes, such as restrictions on endowments or other specialized purposes specified by the funding contributions.

Financial System

In September of 2002 the Commonwealth undertook a two-year project to upgrade its statewide accounting system to a web based software with minimal customizations.

The issuance of this report marks the completion of the first full year of implementation.. The system is on track, meeting the major success factors outlined at the initiation of the project, including:

- The system went live on schedule at the opening of FY05.
- The project came in under budget returning \$2 million of the project contingency fund.
- The system was available to users 96% of its scheduled up time, 9:00 AM until 6:00 PM Monday through Friday. The system is usually available for additional time in the morning outside these planned hours.
- 100% of critical payments were issued on schedule. The system issued a payment file to the Treasurer each day

with the exception of two. On these two days the problem was corrected within 24 hours.

- 1.3 million payments, totaling \$31.5 Billion, have been issued by the system.
- Billings over \$1.9 million to the federal government were executed.
- The financial statements contained herein were prepared using the system and issued on schedule with an unqualified opinion included on pages 23 and 24. No material weaknesses were identified.

Some issues and challenges remain:

- The nightly cycle still frequently requires manual intervention to complete on schedule.
- On line response time occasionally slows down preventing users from working effectively in the system.
- Users still request additional training and assistance in some of the more complicated areas of the application.

While these areas result in frustration they are not serious enough to impede the Commonwealth functions. The Chief Information Officer of the Commonwealth, CGI-AMS and I have an aggressive action plan monitored on a weekly basis to address these remaining issues.

Conclusion

The Commonwealth has many accomplishments in FY05 of which it can be proud.

As stated at the outset of this introduction, the Commonwealth has successfully implemented the updated MMARS system. We couldn't have presented this report without the PARTNERS effort with departments begun four years ago. The fourth Chief Fiscal Officers (CFO) conference brought together CFOs from across the Commonwealth for meetings. PARTNERS stands for people, accountability, responsibility, trust, negotiation, efficiency, risk assessment and mitigation, and solutions. We have emphasized that systems depend on people who are integral to those systems. This recognizes that fiscal officers of the Commonwealth are being given increased authority and at the same time being held accountable for their actions, ensuring a balance of efficiency and integrity of the financial operations of the Commonwealth. We strike this balance between efficiency and integrity of operations through constant risk assessment and effective risk mitigation. As part of this effort, our office has started a Quality Assurance Bureau, that is tasked to not only improve the integrity of the financial operations of the Commonwealth in a collaborative manner with departments, but also to do the same for our internal operations, similar to entities found within non-governmental entities. We will continue to strive to find solutions to many of the Commonwealth's problems in conjunction with the rest of the CFOs, so that full input is heard. To this end, we have commenced a departmental advisory group to provide to us continuous feedback on MMARS and other financial operations.

Part of the strategy of the MMARS upgrade was to ensure that the Commonwealth can upgrade to current releases in the future at a reasonable cost. The goal is to keep current with technology in the future and at the same time control the total cost of system ownership. Benefits will accrue directly to the users of the financial system. In addition, this updated technology will allow for the future integration of Commonwealth internet-based applications into “back office” financial systems. We will use this same strategy as we begin the process of upgrading the Commonwealth’s Human Resource Compensation Management System (HRCMS,) beginning in FY06.

Departments had many challenges during FY05 as part of the implementation of MMARS. Business practices had to be reassessed and in some cases, personnel had to be redeployed to meet these challenges. Throughout it all though, we maintained the high standards of internal controls because we were all conscious of the risk environment that we do business in. The challenge of maintaining effective controls is greater than ever. We continue to ask each department, at its highest levels, to assess its risks and target controls to manage those risks efficiently and effectively. To this end, the Office of the Comptroller, in conjunction with the Office of the State Auditor, has continued a multi-pronged effort to improve controls throughout the Commonwealth.

I again would like to express my thanks to the many dedicated employees within the Office of the State Comptroller. We have had another successful year within the office, though filled with many long hours for all of us to get to this day. I am proud to have all the employees of the Comptroller’s Office on my team to help tackle these and other difficult issues of the future.

Respectfully submitted,

Martin J. Benison
Comptroller of the Commonwealth